

**Testimony by Mark E. Kaplan
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**House Financial Services Committee,
Subcommittee on Oversight and Investigations**

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Madam Chair, Mr. Gutierrez, Members of the Subcommittee, I thank you for the opportunity for SG Cowen to participate in this important hearing.

On behalf of SG Cowen, at the outset I want to pledge our company's full support for your efforts. We applaud the committee for its leadership in working to protect investors from fraud or other abuses.

I also want to say at the outset that we were as shocked as anyone to learn of Frank Gruttadauria's fraud. SG Cowen is committed to doing everything possible to get to the bottom of this scheme, and to do what's right for our former customers.

I want to begin my testimony by briefly reviewing SG Cowen, our short involvement in the retail brokerage business, and where Frank Gruttadauria fit into that business.

SG Cowen today is an investment banking firm that serves a wide array of corporate clients and institutional investors. The firm has a specific focus on technology, health care and related high growth sectors and provides research, financing and a variety of investment solutions to our institutional customers. The firm has more than 600 employees based in a number of cities in the U.S. and around the world.

In July 1998, SG Securities purchased most of the assets of Cowen & Company, a wholly unrelated firm. Frank Gruttadauria worked for this other company for over eight years. He worked for us for just over 2 years.

SG Securities did not have a retail brokerage business until this acquisition. With the purchase, SG Cowen was formed as an investment banking and retail brokerage in the United States.

The acquisition took place after the customary due diligence and audit of Cowen & Company. SG Cowen made a number of changes in the former Cowen & Co. retail brokerage operations after acquiring it. These changes included several steps, some taken in response to a New York Stock Exchange consent order, designed to upgrade compliance and supervisory procedures at the retail unit.

Cowen & Company's retail brokerage business did not fit into our overall business strategy, so it was sold to Lehman Brothers in October 2000. Our firm has been out of the retail brokerage business since the time of that sale.

Because we sold that business, we are faced with a unique and difficult challenge in piecing together what has happened in the Gruttadauria scheme. We face some very significant challenges in our efforts to uncover how these acts were perpetrated and their precise financial impact on each of our former customers. It has turned out to be a painstaking and labor-intensive process peculiar to us.

First is the fact that virtually everyone involved in SG Cowen's retail brokerage business no longer works for our firm. In other words, all our institutional knowledge left for Lehman Brothers over one and one-half years ago. And the senior-most management of SG Cowen has changed completely since the retail brokerage was sold. The fact that none of us in current management -- including myself -- were present at the creation of this situation further complicates the investigation. But though we come to this task as virtual outsiders, we clearly recognize our obligation to do what's right for our former customers.

Second, the files we are researching are stored on vast amounts of paper and microfiche that we warehoused when we sold the retail business to Lehman. The electronic and computer systems of the retail brokerage went with the retail brokerage when Lehman acquired it -- along with the ability to perform swift research on client databases. This means that we must painstakingly review these paper and microfiche sources in order to reconstruct accurate records for each of SG Cowen's former retail customers. I believe at one point we had rented out all seven existing microfiche printers in New York, and were burning them out on a regular basis.

Third, we are faced with the task of reviewing literally hundreds of thousands of transactions over the years, and each one must be examined.

Lastly, we are attempting to unravel a scheme that escaped detection notwithstanding due diligence, compliance procedures and independent reviews by several distinct responsible companies, law firms and other outside entities. The fact that Gruttadauria was able to continue his various acts of misconduct for so long at so many different companies while evading detection underscores the complexity and sophistication of this fraud. Even so, speaking for SG Cowen, we sincerely wish our efforts had uncovered it earlier.

While we are faced with real challenges, we know where our responsibility lies. Our job is to ferret out what really happened, and to understand what it means for our former customers.

To that end, SG Cowen has dedicated substantial company resources to the complex task of reconstructing and analyzing customer records. Well over 100 people have been helping on this nearly round-the-clock effort, including, at any given time, approximately 35 lawyers, 15 paralegals, 42 accounting professionals and numerous other document reviewers and preparers who have been dedicated full time or more than full time for the past three and a half months to the intensive record re-creation process to

which we are committed. We estimate that more than 30,000 person-hours have been expended in this massive effort. And we are far from finished.

Through these efforts, we have provided actual account statements and other account information to all of our former customers who have requested it.

But providing these customers with accurate statements is by no means the same as understanding fully the flow of funds in, out and across accounts over the years. An account statement shows funds that came in and funds that came out. But until you look at the actual checks, wire transfers, deposit slips and other materials, there is no way of knowing whose money went where.

Since the Gruttadauria problem came to our attention, our team has searched for and reviewed more than twelve hundred boxes of company records, including account agreements, monthly statements, correspondence, and literally millions of securities transactions, cash deposits and withdrawals. We are continuing to review additional boxes of records, including another ten thousand boxes of banking records that will help us document the monies that were deposited into our customers' accounts. For every transaction in every account, we must locate manually the documentation that will enable us to determine what happened in that transaction. For example, for every check written against the account of one of Gruttadauria's customers, we must find the cancelled check in a huge collection of boxes of the firm's banking records, determine to whom the check was written, who endorsed it, and whether that person or company was connected to the

person whose account the funds came from or whether the check otherwise was authorized by the customer whose account the check was drawn against, or on the other hand, whether the payee was an unrelated party or other customer of Gruttadauria to whom the customer had not authorized the check to be sent. Similarly, for every wire transfer, we have to track down the wire transfer document, identify the account from which the funds came, attempt to determine to whom the funds were being transferred, and, again, whether the recipient was related to the person whose funds were being transferred. This process is going on day and night, including as you read this, for hundreds of thousands of transactions in hundreds of accounts over many years.

Nonetheless, we have learned some things in this process, which I would like to share with the committee. Before I do, I must say that, due to the existing SEC and New York Stock Exchange investigations of this matter and pending private litigation, I am not at liberty to discuss the specifics of any individual investor case or our preliminary findings.

What I can say is that we have found that Gruttadauria sent a significant number of customers bogus account statements that falsely represented to the customers that they were earning far more in their accounts than they actually were. When they sought to withdraw funds based on the inflated balances on their statements, Gruttadauria apparently concluded that, to keep the customers from complaining, he had to get the funds to pay them from somewhere -- and that somewhere turned out to be the accounts of other customers. That appeared to require him to provide false statements to the other customer, and so the scheme grew.

Thus, at its root, this was a scheme in which Frank Gruttadauria appears to have been robbing Peter to pay Paul. There are still many questions that remain: why did he start this? how many customer accounts did he victimize? how much did the customers lose? did some customers wind up with substantially more money than they invested? These are the questions we're trying to answer.

The net of Gruttadauria's actions had the effect of linking customer accounts together. Funds or securities went into one customer's account but were used to pay another customer who wanted to make a withdrawal. What happened in one account clearly has effects on several others. That means that we need to understand what happened with all transactions in all the affected accounts before we are in a position to determine what it would take to attempt to compensate each individual former customer who lost money.

Again, we are pursuing this task with great urgency – but it will take time.

Members of this committee, we offer our sincere apology for the harm that Frank Gruttadauria's conduct has caused the former clients of SG Cowen.

His conduct is anathema to us. That's not the way we do business and that's not who we are. We are proud of our hard-earned reputation for integrity in the marketplace and of the work we do for our clients.

That is why SG Cowen will continue to work tirelessly to determine exactly what happened and make every effort to do the right thing for our former customers. We know that can't happen fast enough for them; and they are absolutely right. That is why we are working so hard to reconstruct the past.

With that, I thank you very much, and welcome the chance to answer any questions you might have.

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